

**Watco Companies, Inc.**  
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July 17, 2006

Mr. Richard Timmons  
President  
American Shortline and Regional Railroad Association  
50 F. Street, NW, Suite 7020  
Washington, D.C. 20001

Dear Mr. Timmons:

Thank you for the opportunity to share the thoughts of the leadership team of Watco Companies, Inc. with you on the potential challenges facing the railroad industry for the balance of 2006. Let me assure you that we have been working diligently over the past year to insure we once again have optimum performance during the railroad peak service season.

We have identified four broad areas for improvement that have been embraced at all levels of our 16 shortline railroads and we believe that our performance results demonstrate we are capable of handling potential freight surges this fall. These four areas are: better data and operating measurements; increased track investments; heightened awareness on safety; and improved locomotive investment and performance.

1. **Better data and operating measurements**

In the past year we have made additional improvements to our on-time delivery system measurement. This is a daily report, by railroad and by railcar, showing not only current status of deliveries but projecting our performance days ahead of time. In this way we are able to make operating adjustments ahead of the demand to make sure that our Customers receive the right car, at the right time, in the right condition at the right price. We have implemented this system on all of our roads and have seen the results from improved on-time performance. Our goal is not to get the car to the Customer early, but on time to best meet their needs.

We are continuing to make improvements to this forecasting system and believe it is a great tool for our team leaders to manage our roads.

2. Increased track investments

Due to the passage of the income tax credit we have made an additional \$12 million in track improvements over previous spending. This has been major tie replacement projects, miles of rail relay, and an aggressive surfacing program that is improving the overall quality of our network. We have entire sections of railroad that were 10 mph and were faced with impending abandonment that are now in great shape and operating at 25 mph. This has improved our velocity, using fewer crew hours, fewer locomotives, and fewer rail cars to get the same job done.

This single area is one of significant continued long-term importance for our railroads and our industry. We encourage the STB to lend their support in the reauthorization of the tax credit as it has a direct impact on the improved service of our industry.

3. Heightened awareness on Safety

Nothing slows a railroad down more than safety events. They are destructive to the infrastructure, demoralizing to the employees, not to mention the real toll they have on our employees. We have once again made safety a priority and have worked very hard to reduce any safety event on every one of our properties. We now have a safety performance record that is better than the shortline industry average, but that isn't good enough. We want to someday lead the Shortline industry in being the safest railroad network in America.

We have added safety officers, testing, awards programs, raised awareness and made proper recognition for proper safety performance.

4. Improved locomotive investment and performance

Finally, we have made a multi-million dollar commitment to upgrade our locomotive fleet by adding 12 additional SD 50 locomotives to our fleet. These bigger and more powerful locomotives are better suited to pull the heavier and longer trains in the peak season and we are already seeing their positive impact in our daily performance. These motors replaced other GP38's and GP40's that are now able to perform other duties on our lines.

In addition to the greater number of locomotives we are also taking longer and more frequent maintenance opportunities with the entire locomotive fleet. To say this another way, instead of operating the locomotive until there is a failure, with our additional locomotive capacity we are able to do more preventive maintenance to avoid unscheduled down time. This is a very important part of improving our operating performance to meet the needs of our Customers.

While we are also making other improvements in employee training, car fleet management, Customer service, and the utilization of technology, these are four key areas that are receiving the bulk of our attention. I look forward to sharing our results with you next year.

I hope this information is helpful and meets the needs of the STB.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Ed".

A.E. McKECHNIE  
Chief Commercial Officer  
Watco Companies, Inc.